LOUISIANA STATE UNIVERSITY
HEALTH SCIENCES CENTER IN SHREVEPORT
LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA

MANAGEMENT LETTER
ISSUED DECEMBER 15, 2010

LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397

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Our procedures at Louisiana State University Health Sciences Center in Shreveport (center) for the period July 1, 2009, through June 30, 2010, disclosed:

- For the third consecutive year, the center continues to have a performance-based energy efficiency contract that includes stipulated savings and therefore does not comply with state law.

- The two findings identified in the prior year report on the center, dated May 26, 2010, relating to failure to capture and bill for all services provided and noncompliance with state property control regulations have been resolved by management.

- No significant control deficiencies or errors were identified relating to the selected accounts for which assurance was provided to the Louisiana State University System (System), including cash and cash equivalents, other postemployment benefits payable, net assets, educational departments' revenues, and hospital revenues.

- No significant control deficiencies or noncompliance issues were identified that would require reporting under Office of Management and Budget (OMB) Circular A-133 for the State Fiscal Stabilization Fund Program (CFDA 84.394) for the fiscal year ended June 30, 2010.

- No significant control deficiencies or noncompliance issues were identified that would require reporting under OMB Circular A-133 for the Research and Development Cluster for the fiscal year ended June 30, 2010.

We did not audit the financial information provided to the System by the center; however, we did perform certain procedures in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States as part of our audit of the System's financial statements and in accordance with OMB Circular A-133 as part of the Single Audit of the State of Louisiana. This report is a public report and has been distributed to appropriate state officials. We appreciate the center's assistance in the successful completion of our work.

Background

The primary mission of the center is to provide education, patient care services, research, and community outreach. The center encompasses the Schools of Medicine, Graduate Studies, and Allied Health Professions in Shreveport, LSU Hospital in Shreveport, E.A. Conway Medical Center in Monroe, and Huey P. Long Medical Center in Pineville. In implementing its mission, the center is committed to:

- Educating physicians, basic scientists, residents, fellows and allied health professionals based on state-of-the-art curricula, methods, and facilities, preparing students for careers in health care service, teaching or research.

- Providing state-of-the-art clinical care, including a range of tertiary special services, to an enlarging and diverse regional base of patients.

- Achieving distinction and international recognition for basic science and clinical research programs that contribute to the body of knowledge and practice in science and medicine.

- Supporting the region and the state in economic growth and prosperity by using research and knowledge to engage in productive partnerships with the private sector.

LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

November 18, 2010

LOUISIANA STATE UNIVERSITY HEALTH SCIENCES CENTER IN SHREVEPORT
LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Shreveport, Louisiana

As required by Louisiana Revised Statute 24:513 and as a part of our audit of the Louisiana State University System's (System) financial statements and the Single Audit of the State of Louisiana for the fiscal year ended June 30, 2010, we conducted certain procedures at Louisiana State University Health Sciences Center in Shreveport (center) for the period from July 1, 2009, through June 30, 2010.

- Our auditors obtained and documented an understanding of the center's operations and system of internal controls through inquiry, observation, and review of the center's policies and procedures documentation including a review of the related laws and regulations applicable to the center.

- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using the center's financial information provided to the System and obtained explanations from center management for any significant variances.

- Our auditors considered internal control over financial reporting, examined evidence supporting certain accounts and balances material to the System's financial statements, and tested the center's compliance with laws and regulations that could have a direct and material effect on the System's financial statements for the fiscal year ended June 30, 2010, in accordance with *Government Auditing Standards*.

- Our auditors considered the center's internal control over compliance with requirements that could have a direct and material effect on major federal programs, as defined in the Single Audit of the State of Louisiana, and we tested the center's compliance with laws and regulations that could have a direct and material effect on the State Fiscal Stabilization Fund Program and the Research and Development Cluster as required by U.S. Office of Management and Budget Circular A-133 for the fiscal year ended June 30, 2010.

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- Based on the documentation of the center's controls and our understanding of related laws and regulations, procedures were performed on the center's recorded cash and cash equivalents, other postemployment benefits payable, net assets, educational departments' revenues, hospital revenues, educational and general expenses, and hospital expenses.

The financial information provided to the System by the center was not audited or reviewed by us, and, accordingly, we do not express an opinion on that financial information. The center's accounts are an integral part of the System's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

In our prior management letter for the year ended June 30, 2009, we reported findings relating to energy efficiency contract contrary to law, failure to capture and bill for all services provided, and noncompliance with state property control regulations. The findings relating to failure to capture and bill for all services provided and noncompliance with state property control regulations have been resolved by management. The finding relating to energy efficiency contract contrary to law is addressed again in this management letter.

Based on the application of the procedures referred to previously, one significant finding is included in this letter for management's consideration. We found no significant control deficiencies, noncompliance, or errors relating to our analytical procedures or our procedures on the center's cash and cash equivalents, net assets, other postemployment benefits payable, educational departments' revenues, and hospital revenues that should be communicated to management.

Energy Efficiency Contract Contrary to Law

For the third consecutive year, the center continues to have a performance-based energy efficiency contract with Johnson Controls, Inc. (JCI) in place, entered into in July 2002, that includes stipulated savings and therefore does not comply with state law. In addition, the other components of guaranteed savings in the contract (measurable operational and utility savings) are not being adequately measured or verified by management. Louisiana Revised Statute (R.S.) 39:1496.1(A) provides that a state agency may enter into a performance-based energy efficiency contract for services and equipment. R.S. 39:1484(A)(14) requires the payment obligation to be either a percentage of the annual energy cost savings attributable to the services or equipment under the contract or guaranteed under contract to be less than the annual energy cost savings attributable to the services or equipment under the contract. R.S. 39:1496.1(C)(1) requires the contract to contain a guarantee of energy savings to the entity. Furthermore, R.S. 39:1496.1(D) provides that the annual calculation of the energy savings must include maintenance savings that result from operation expenses eliminated and future capital replacement expenditures avoided as a result of equipment installed or services performed by the contractor.

Attorney General Opinion 07-0002 provides "…for the stipulated operational savings to be included in the total guaranteed savings, those savings must actually be guaranteed. In order for the operational savings to be guaranteed, the Contract would have to provide for some type of measurement and/or verification of the operational savings….” Although the attorney general opinion was directed to local government, the same guarantee is required in state law; therefore, the conclusion is the same.

In addition, good internal control dictates that the terms and conditions of contracts entered into on behalf of an institution should be monitored to ensure that all parties involved in the contract are fulfilling their obligations. At a minimum, controls should include reconciling, measuring, and verifying all financial aspects of the contract to ensure compliance with applicable terms and conditions.

A review of the energy efficiency contract, which is for 17 years and approximately $15.7 million, between the center and JCI disclosed the following deficiencies:

- JCI guaranteed a total of $15,493,562 in savings during the term of the contract, consisting of measurable utility savings of $8,926,000; measurable operational savings of $3,480,869; and stipulated operational savings of $3,086,693. According to the contract, “Stipulated Operational Savings are mutually agreed by the Customer and JCI … and shall not be measured or monitored during the Term of the Agreement.” The contract also provides that stipulated operational savings include repair and maintenance costs avoided by the customer through the implementation of the Performance Contracting Agreement. The stipulated operational savings are not guaranteed because the contract does not provide for measurement and/or verification of the stipulated operational savings. Therefore, excluding the stipulated operational savings, the guaranteed savings over the life of the contract are only the measurable savings of $12,406,869. The total payments due to JCI over the life of the contract are approximately $15.7 million. Therefore, the payment obligation exceeds the adjusted guaranteed annual energy cost savings.

- Neither the measurable utility savings nor the measurable operational savings are being adequately measured or verified. The contract was not adequately monitored to ensure that all deliverables required to be provided to the center in the contract were provided, which includes a “copy of the software and associated documentation to calculate the project savings,” which would allow for calculating the savings using the same methodology as the vendor so that the savings could be measured and verified.

At the signing date, management felt that the contract complied with state law. However, because the contract includes stipulated savings that are not measurable, the contract is not in compliance with state law. In addition, by failing to perform the necessary measurements and verifications of measurable savings, the center is unable to determine if actual savings are in excess of the cost of the contract. Also, there is a risk of making payments specified in the contract that are greater than the energy cost savings attributable to the services or equipment under the contract.

The System's counsel has represented to us that he has conducted a detailed investigation and evaluation of the agreement, has retained an industry expert to assist in a comprehensive review of the technical materials and calculations associated with this contract, and is currently actively engaged in extensive settlement discussions with JCI's local counsel regarding resolution of the issues associated with this contract.

Once again, we recommend that management should consult its legal advisors to reconstruct its energy efficiency contract in accordance with state law. In addition, management should ensure that contract terms and conditions are adequately monitored to ensure that the center receives the actual savings specified in the contract. Also, management should ensure that the payments required by the contract are not greater than the energy cost savings attributable to the services or equipment under the contract. System management concurred with the finding and outlined its ongoing negotiations with JCI (see Appendix A).

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the center. The nature of the recommendations, their implementation costs, and their potential impact on the operations of the center should be considered in reaching decisions on courses of action. Since this finding relates to the center's compliance with applicable laws and regulations, it should be addressed immediately by management.

This letter is intended for the information and use of the center and its management, others within the entity, the System, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

WMS:BAC:BDC:THC:dl

LSUHSCS 2010

Management's Corrective Action Plan and Response to the Finding and Recommendations

Louisiana State University System
3810 West Lakeshore Drive
Baton Rouge, Louisiana 70808

Chief Financial Officer

225 / 578-6935
225 / 578-5524 fax

October 19, 2010

Mr. Daryl G. Purpera, CPA
Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804-9397

Re: Audit Finding - Energy Efficiency Contract Contrary to State Law

Dear Mr. Purpera:

I am writing in response to your letter dated October 6, 2010 to Chancellor Martin regarding fiscal year 2010 Audit findings associated with a performance-based energy efficiency contract between Johnson Controls, Inc. (JCI) and LSU and also in response to your letter dated October 12, 2010 to President Lombardi with virtually identical audit findings for each of the other four LSU System institutions that are also currently party to a performance-based energy efficiency contract with JCI, specifically, the University of New Orleans, Louisiana State University Health Science Center in Shreveport, University Medical Center, and Lallie Kemp Hospital. This letter is meant to serve as the LSU System's response to any similar findings regarding each of these contracts for the 2010 fiscal year.

As noted in your findings, and in previous correspondence to your office from the LSU System (see attached), LSU System's counsel has conducted detailed investigations of each of these agreements and has retained an industry expert to assist in the review of the complex technical materials and calculations. After working with the expert and the five facilities to determine the status and history of these contracts and after attempts to obtain relevant information from JCI's out-of-state counsel, notice of default was sent to JCI on February 3, 2010. The LSU System's counsel indicated the LSU System's position with regard to each of these contracts and informed JCI that these issues must be resolved. On February 5, 2010, LSU's counsel was contacted by new, local counsel for JCI who indicated that JCI was willing to actively work to resolve the issues related to each of these contracts. Since this time, numerous meetings and correspondence have taken place between LSU System counsel, JCI local counsel and the five LSU System institutions regarding the status of each of the five contracts, the unique issues associated with performance under each contract, issues associated with savings under each contract, termination options for each contract and the most appropriate method of addressing any other issues under each contract. During the past month, JCI and the LSU System have exchanged terms associated with a proposed termination of the Louisiana State University Health Sciences Center, Shreveport contract. Currently LSU is awaiting a response from JCI on its proposed terms and hopes to move forward with similar negotiations related to each of the four other contracts in an effort to avoid costly litigation. Should negotiations be unsuccessful, LSU is prepared to institute litigation to resolve the issues associated with these contracts by nullifying the agreements, forcing amendments to the agreements or recovering for breach of the agreements.

Sincerely,

Wendy C. Simoneaux

Wendy C. Simoneaux
Chief Financial Officer

Enclosure

Cc: General Counsel P. Raymond Lamonica